79-1402

Supreme Court, U. S.
FILED
APR 11 1980
CLERK

IN THE

Supreme Court of the United States

IVEN S. YOUNG, ET AL.,

Petitioners,

-against-

DISTINCTIVE DEVICES, INC.,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR CERTIORARI

SEYMOUR SHAINSWIT OF
KRONISH, LIEB, SHAINSWIT
WEINER & HELLMAN
Attorney for Respondent
Distinctive Devices, Inc.
1345 Avenue of the Americas
New York, New York 10019
(212) 765-6000

Of Counsel:

Brian J. Gallagher

71)

COUNSEL PRESS, INC., 55 West 42nd Street, New York, N.Y. 10036 • (212) 391-6622

TABLE OF CONTENTS

		PAGE
1.	Question presented on this petition.....	2
2.	Statement of the case.....	2
	(a) Summary.....	2
	(b) The undisputed facts.....	3
	(c) Proceedings below.....	5
	(d) The present petition.....	7
3.	Section 316(b) does not prohibit subordinated debentures.....	8
4.	Conclusion.....	15

TABLE OF AUTHORITIES

PAGE

Cases:

Continental Bank & T. Co. v. First Nat. Petroleum T., 67 F.Supp. 859 (D.R.I. 1946).....9, 11, 12, 13

Missouri Pac. R. Co. v. Elmore & Stahl, 377 U.S. 134 (1964).....11

Schallitz v. Starrett Corp., 82 N.Y.S.2d 89 (Sup. Ct. 1948).....8, 13, 14

Statutes:

15 U.S.C. 77ppp.....passim

15 U.S.C. 77rrr.....7

Other Authorities:

H.R. Rep. No. 1016, 76th Cong. 1st Sess. (1939)...8-9, 10, 11

American Bar Foundation, Commentaries on Indentures (1971).....14

II Loss, Securities Regulation (2d ed 1961).....8-9

Calligar, Subordination Agreements, 70 Yale L.J. 376 (1961).....14

Coogan, Kripke & Weiss, The Outer Fringes of Article 9: Subordination Agreements, Security Interests in Money and Deposits, Negative Pledge Clauses, and Participation Agreements, 79 Harv. L.R. 229 (1965).....14

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1976

NO 79-1402

IVEN S. YOUNG, et al.,

Petitioners,

-against-

DISTINCTIVE DEVICES, INC.,

Respondent.

RESPONDENT'S BRIEF IN OPPOSITION TO THE PETITION FOR CERTIORARI

---

1. Question presented on this petition.

Whether, as Petitioners must contend, Section 316(b) of the Trust Indenture Act of 1939, 15 U.S.C. §77ppp ("Section 316(b)") outlaws subordination provisions.

2. Statement of the case.

(a) Summary.

The facts have never been disputed. A. 1, 2.* The law is clear. Point 3 infra. Petitioners bargained for and purchased subordinated debentures. The event of subordination has occurred. Section 316(b) does not prohibit such debentures. Nor does it excuse an event of subordination. Rather, the statute prohibits unconsented later changes in the payment rights prescribed in deben-

---

* Citations preceded by the legend "A" are to the pages of the Appendix attached to the Petition for Certiorari.

ture instruments. It has no application to this case.

(b) The undisputed facts.

Petitioners bought $12,000 of the $4 million of the "6-1/2 Convertable Subordinated Debentures Due December 1, 1983" (the "Subordinated Debentures") issued by Respondent in December, 1968 R. 20, 23.*

The Subordinated Debenture flatly stated that: (1) the right to payment of principal and interest would be subordinate to the rights of senior debt as provided in the Indenture; and, (2) each holder accepted and agreed to

---

* Citations preceded by the legend "R" are to the pages of the Record on Appeal presented to the Supreme Court of the State of New York, Appellate Division, First Department and placed before this Court by Petitioners.

that subordination by taking the Subordinated Debenture. R. 24.

In turn, the Indenture expressly subjected the debenture holders' rights to payment of principal and interest to the subordination provisions. Indenture Section 508, R. 70. The controlling subordination provisions prohibited payment of principal or interest on the Subordinated Debentures at any time during which defined senior debt should be in default. Indenture Section 1405, R. 122.

Interest on the Subordinated Debentures was timely paid from 1969 until December 1977. At that point, a senior debt default intervened. That default has continued. R. 26. No interest payments have been made since 1977. R. 26.

On April 28, 1978, the Indenture Trustee informed Petitioners and the other Subordinated Debenture holders that it appeared that the interest default would continue at least into 1980. The Trustee cautioned that a formal default declaration would be likely to cause insolvency proceedings in which the Subordinated Debenture holders would receive nothing. R. 139-40.

There has been no declaration of default under the terms of the Indenture and no acceleration of the principal obligation. Principal is not due until 1983. R. 23.

(c) Proceedings below.

The Petitioners immediately sued for the $12,000 principal amount of their debentures and for accrued

interest.* R. 18. That suit was dismissed as legally deficient by the Special Term of the New York Supreme Court. The debentures were clearly subordinate. The event of subordination had occurred and persisted. There had been no declaration of default under the Indenture. There was no right to interest payment until the senior debt default had been

---

* Petitioners do not represent more than one percent (1%) of the outstanding debentures. R. 28. No demand has been made on the Trustee for a formal default declaration or for the institution of suit. The Indenture prohibits suit by holders unless instituted by the holders of at least twenty-five percent (25%) in value of the outstanding debentures at least sixty (60) days after the Trustee has been requested, but has failed, to sue. Indenture Section 507, R. 69-70.

The decisions below do not deal with this defect in plaintiffs suit except en passant in connection with the lack of any formal default declaration under Section 502 of the Indenture (R. 29.). A. 3.

These issues would obviously arise on a full hearing on the merits.

cured or waved. And, there was no right to sue for principal until a formal declaration of default and acceleration. A. 2-3.

The Appellate Division of the New York Supreme Court summarily affirmed. A. 8-9. The New York Court of Appeals refused to even hear the matter. A. 10-11.

(d) The present petition.

Petitioners now ask this Court to entertain this open and shut case. The proposed notion is that Section 316(b)'s prohibition against the impairment of, or adverse change in, a debenture holder's right to receive payment of principal or interest outlaws subordination provisions in the original debt instruments.* If Petitioners were

---

* 15 §U.S.C. 77rrr provides that Section 316(b), inter alia, overrides inconsistent indenture provisions.

correct, all subordination provisions would be outlawed. By definition, all such provisions impair payment rights. However, Petitioners' legal analysis is wrong.

3. Section 316(b) does not prohibit subordinated debentures.

Section 316 does not forbid subordination provisions in original debt instruments. It only prohibits later unconsented changes which impair or adversely affect a debenture holder's right to receive the interest or principal due him at the time of the purported change in the terms of the debt. II Loss, Securities Regulation, 740 (2d ed 1961); Schallitz v. Starrett Corp., 82 N.Y.S.2d 89, 90 (Sup. Ct. 1948); Report of the Committee on Interstate and Foreign Commerce of the House of Representatives on the Trust Indenture Bill of 1939, H.R.

Rep. No. 1016, 76th Cong. 1st Sess. 36, 56 (1939) (the "House Report"). Accord, Continental Bank & T. Co. v. First Nat. Petroleum T., 67 F. Supp. 859 (D.R.I. 1946).

Petitioners have misread Section 316(b), its legislative history, and the Continental case. Their argument contradicts forty-one years' experience with subordinated debentures under the Trust Indenture Act of 1939.

First, Section 316(b) states that the payment rights prescribed by an indenture security cannot be impaired or adversely affected* without each debenture holder's consent. Nothing in the section even discusses subordination provisions. Section 316(b) does not say that an indenture security

---

* With irrelevant exceptions.

may not qualify, restrict or condition the right to payment in the first instance. Nor does the statute forbid a debenture holder's agreement to subordination at the time of his purchase of a subordinated debenture. And, in any event, such a consent would satisfy the prohibition which only affects uncontested impairments. There is such a consent in this case. R 24.

Second, the legislative history offered by Petitioners contradicts their position and, in fact, demonstrates that Section 316(b) deals only with later changes in payment terms. The House Report states the purpose of Section 316(b) as the insurance of "judicial scrutiny of the fairness of debt-readjustment plans...." House Report, supra at p. 56, emphasis supplied. The draftsmen flatly stated that Section

316(b) deals with changes in indenture rights and waivers of existing defaults -- not with the original definition or limitation of those rights by subordination or other provisions:

> "This prohibition does not prevent the majority from binding dissenters by other changes in the indenture or by a waiver of other defaults, and the majority may of course consent to alterations of its own rights."

House Report, supra, at p. 56, emphasis supplied.

Third, the Continental case deals with a proposed "readjustment" of payment terms -- a moratorium on past due interest payments. The case has nothing to do with original indenture terms.*

---

* Thus there is no conflict between the Continental case and the decision below. Missouri Pac. R. Co. v. Elmore & Stahl, 377 U.S. 134 (1964) can provide no jurisdictional base for this petition.

In Continental

> "the holders of a majority in principal amount of debentures at the time outstanding are attempting to force the postponement of interest payment for a period exceeding three years from its due date."
>
> * * *
>
> "[T]he action of holders of a majority in principal amount of debentures at the time outstanding in attempting to postpone and waive default of the interest payment is directly contrary to the provisions of the Act expressly prohibiting impairment of the right of a debenture holder to receive payment of interest...."

Continental Bank & T. Co. v. First Nat. Petroleum T., supra, 67 F. Supp. at 871. The Continental court held only that such a later change in the indenture provisions regarding interest payments violated Section 316(b). That is, Section 316(b) prohibited a majority of debenture holders from declaring an interest moratorium. The case has

nothing to do with original limitations expressed in debt instruments.*

Schallitz v. Starrett Corp., supra, is the only other published opinion which deals with Section 316(b). There, Justice Botein held that:

> "the statute forbids postponement only of interest actually due and payable by the terms of the indenture security ...."

---

* Indeed, the Continental debentures had two original limitations on payment. Neither was challenged. The debentures were subordinated and they were "income" bonds. Payment of the eight percent (8%) interest was due only if, and to the extent that, there was sufficient "net income" to fund the payment. "Net Income" was defined as funds remaining after payment of operating and administrative expenses, certain taxes, and interest on senior debt. The Securities and Exchange Commission appeared as amicus curiae to aid in the construction of Section 316(b). No challenge was raised to either the subordination or the income limitations.

Schallitz v. Starrett Corp., supra, 82 N.Y.S.2d at 91, emphasis supplied.

Here, the debenture and the indenture both state, indeed advertise, that the right to payment is subordinate to, and conditioned on prior payment of, senior debt.* R. 24, 70, 122. That is,

---

* Petitioners argue that a subordination provision cannot be invoked outside of an insolvency proceeding.

This is simply not so. There are two recognized types of subordination provisions: (1) the "inchoate" provision which is drawn in terms that delay its effect until voluntary or involuntary distribution of the debtor's assets; and, (2) the "complete" provision which prohibits payments as long as senior debt is unpaid. See, e.g., Calligar, Subordination Agreements, 70 Yale L. J. 376, 378 (1961); Coogan, Kripke & Weiss, The Outer Fringes of Article 9: Subordination Agreements, Security Interests in Money and Deposits, Negative Pledge Clauses, and Participation Agreements, 79 Harv. L. R. 229, 233-34 (1965); American Bar Foundation, Commentaries on Indentures, 575-76 (1971).

no interest or principal can be due or payable "by the terms of the indenture security" unless senior debt is current. There has been no change in these payment terms. The existing subordination provisions have merely been invoked.

Petitioners bargained for, bought and paid for their subordinated debt. They have received what they had bargained for. Their rights have not been changed. They have no case.

4. Conclusion.

The petition for certiorari should be denied. No substantial issue is presented. The Trust Indenture Act of 1939 did not outlaw subordination provisions. It cannot be tortured to do so. Petitioners bargained for and received a subordinated debenture. The implementation of the subordination

provisions did not impair or affect any right given them by the debt instruments.

Dated: New York, New York
March 10, 1980

Respectfully submitted,

SEYMOUR SHAINSWIT OF
KRONISH, LIEB, SHAINSWIT
WEINER & HELLMAN

Attorney for Respondent
Distinctive Devices, Inc.

Of Counsel:

Brian J. Gallagher